LATHAM & WATKINS LLP

April 5, 2014

The JOBS Act, Two Years Later:

An Updated Look at the IPO Landscape

Two years ago, the Jumpstart Our Business Startups (JOBS) Act became law. Title I of the JOBS Act significantly changed the IPO playbook, creating a new category of issuer called an emerging growth company (EGC) and rewriting the rules for EGC IPOs. In the second year after the JOBS Act became law, 85% of issuers that priced a US IPO identified themselves as EGCs, up from 75% in the first year.

Building on our first-anniversary JOBS Act report on initial trends observed and lessons learned, we have again conducted a detailed analysis of EGC IPOs, this time taking a close look at 236 EGCs that priced a US IPO in year two.[1]

The information and analysis we present is based on our review of SEC filings, SEC commentary on the JOBS Act and our experience as either issuer's or underwriters' counsel in more EGC IPOs than any other law firm. Here is what we have learned from two years of survey data.

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LESSONS LEARNED IN YEAR TWO

1. *We continue to see similar trends.* More EGCs used the JOBS Act's provisions for confidential submission and scaled financial disclosure in year two than in year one, and the use of other JOBS Act provisions generally remained consistent.

2. *EGCs span many industries, with pharmaceutical companies representing the largest group of EGC IPO issuers.* The top five industries were pharmaceuticals, technology, real estate, energy and healthcare.

3. *Confidential submission has become nearly universal.* Approximately 90% of EGCs that priced an IPO in year two confidentially submitted at least one draft registration statement prior to publicly filing.

4. *Many EGCs are taking advantage of scaled financial disclosure.* Two-thirds of EGCs that priced an IPO in year two provided two years of audited financial statements rather than three years.

5. *The extended phase-in of the internal controls audit remains popular.* Nearly all EGCs that priced an IPO in year two indicated an intention to use this accommodation or reserved the right to do so in the future.

6. *Testing the waters has grown in popularity.* Testing the waters has gained momentum across all industries and is considered as a possibility in almost every deal. The decision whether to test the waters depends on the specific facts of each deal, although issuers in certain industries, such as life sciences, tend to test the waters in nearly every deal.

7. *Research practices remain largely unchanged.* Pre-deal research in connection with EGC IPOs has not emerged, and most market participants voluntarily restrict the publication of research for a contractually agreed period (typically 25 days) following the IPO. EGC research reports have emerged during the former quiet periods surrounding lock-up waivers, as well as secondary and follow-on offerings.

8. *Foreign private issuer interest has increased.* Foreign private issuers (FPIs) represented almost 15% of priced US IPOs by EGCs in year two.

YEAR-OVER-YEAR COMPARISON

The trends we identified in our report one year ago have either increased or held steady. The chart below compares the data we reported one year ago to the data we gathered during the past year.[2]

Trend	Year Two	Year One
Percentage of total US IPOs completed by EGCs	85%	75%
Percentage of EGCs that are also foreign private issuers	15%	10%
EGCs that submitted at least one registration statement confidentially	90%	65%
EGCs that provided only two years of audited financial statements	65%	50%
EGCs that indicated an intention to use the extended phase-in for Section 404(b) of Sarbanes-Oxley or reserved the right to do so in the future	98%	97%
EGCs providing scaled executive compensation disclosure	85%	75%
EGCs opting out of the extended phase-in for new accounting standards	77%	80%

EGC IPOS BY THE NUMBERS

An EGC is a company with annual revenue of less than $1.0 billion for its most recently completed fiscal year, subject to disqualification events.[3] In the past two years, companies with less than $250 million in annual revenue accounted for approximately 85% of priced EGC IPOs. During year two, FPIs represented almost 15% of priced EGC IPOs, compared to 10% during year one.

Eleven master limited partnerships (MLPs) and 13 real estate investment trusts (REITs) priced IPOs as EGCs during year two. As of March 31, 2014, 107 EGCs are publicly in registration with the SEC.[4] Most of these issuers are in the technology, pharmaceutical or real estate industry.

USE OF EGC ACCOMMODATIONS

Title I gives EGCs a menu of options and allows them to choose all, some or none of the on-ramp accommodations. EGCs continue to use these accommodations to varying degrees.

- **Testing the Waters** – Before or after filing a registration statement, EGCs may meet with qualified institutional buyers (QIBs) and other institutional accredited investors to gauge their interest in a contemplated offering.
- **Confidential SEC Review** – EGCs may initiate the SEC registration process confidentially.
- **Scaled Financial Disclosure** – EGCs may go public using two years, rather than three years, of audited financial statements and as few as two years, rather than five years, of selected financial data.

- **Internal Controls Audit** – EGCs are exempt from the internal controls audit required by Section 404(b) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).
- **Executive Compensation Disclosure** – EGCs may use streamlined executive compensation disclosure and are exempt from the shareholder advisory votes on executive compensation required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).
- **Extended Phase-In for New GAAP** – EGCs may use private-company phase-in periods for new accounting standards.
- **PCAOB Rules** – EGCs are exempt from any Public Company Accounting Oversight Board rules that, if adopted, would mandate auditor rotation or auditor discussion and analysis.

PRACTICE POINT

Determining Which EGC Accommodations to Use

At the very beginning of the IPO process, the issuer, the underwriters and counsel should consider which EGC accommodations to use. This discussion should take account of industry trends, market forces, the unique facts and circumstances of the issuer and the offering as well as materiality considerations generally. For example, some EGCs may elect to include additional executive compensation or historical financial information on a voluntary basis where the information is readily available and circumstances warrant its inclusion.

Testing the Waters

EGCs and their underwriters or other authorized persons may engage in oral or written communications with QIBs and other institutional accredited investors before or after the initial filing of a registration statement in connection with assessing investor interest in a proposed offering.[5] This testing-the-waters provision significantly modified the communications restrictions under Section 5 of the Securities Act and authorized a new way to approach the market.

Testing the waters is occurring more frequently and is especially popular in certain industries such as life sciences and technology, where issuers tend to have shorter operating histories and often need to communicate highly scientific or technical information to potential investors.

In other industries, the option of testing the waters is usually at least explored by the deal team and, in our experience, is becoming a more commonly used part of the IPO playbook. The ultimate decision whether to test the waters and the timing of these meetings depends on specific circumstances. In our experience, the majority of testing-the-waters meetings take place after confidential submission and before public filing, but we have also seen deals where testing-the-waters meetings occur during the 21-day period prior to the launch of the road show. Testing the waters can provide helpful information to EGCs and their underwriters as they determine the size and timing of a proposed IPO.

EGCs must proceed carefully if they decide to test the waters with potential investors. The deal team should consider how much detail to include in testing-the-waters materials, based on when testing the waters occurs and bearing in mind that the antifraud provisions of the federal securities laws apply to the content of these communications.[6] As with traditional road-show materials, testing-the-waters materials should also be reviewed for consistency with the information contained in the registration statement. Market participants typically do not leave written testing-the-waters materials behind.

Typical underwriter guidelines for testing-the-waters meetings specify (1) the procedures for setting up and carrying out the meetings, (2) the parameters for the materials that can be used, (3) the specific investors that may be approached to participate and (4) the ground rules for the meetings. Testing-the-waters guidelines may also prohibit research analysts employed by participating firms from attending testing-the-waters meetings and/or outline specific procedures for sales force and investment banking personnel.

The SEC Staff has taken an interest in testing-the-waters communications and often issues a comment seeking copies of written materials used to test the waters:

> *Please supplementally provide us with copies of all written communications, as defined in Rule 405 under the Securities Act, that you, or anyone authorized to do so on your behalf, present to potential investors in reliance on Section 5(d) of the Securities Act, whether or not they retain copies of the communications.*

Approximately 20% of EGCs that received this comment responded affirmatively by supplementally providing written materials to the SEC Staff.[7]

PRACTICE POINT

Responding to the SEC Staff's Request for Testing-the-Waters Materials

The SEC Staff has indicated a desire to review testing-the-waters materials for consistency with the registration statement. The Staff has indicated that the materials will not be posted to EDGAR or otherwise made public by the SEC if correctly submitted. We recommend the following:

- Provide the materials supplementally in hard copy. Do not submit them to your SEC examiner via email or through EDGAR.
- Include the following confidential treatment request legend on each page of the materials: "CONFIDENTIAL TREATMENT REQUESTED BY [ISSUER NAME] UNDER SEC RULE 83" and comply with the other requirements of Rule 83 with respect to the submission.
- In the cover letter enclosing testing-the-waters materials, cite Securities Act Rule 418(b) and ask the SEC Staff to return the enclosed materials.

Confidential SEC Review

EGCs (including those that are FPIs) may confidentially initiate the SEC registration process by submitting a draft registration statement for nonpublic review by the SEC Staff.[8] The Staff's review of a confidential submission should not take any longer than its review of a publicly filed registration statement (expect your first set of comments within 30 days of submission).

PRACTICE POINT

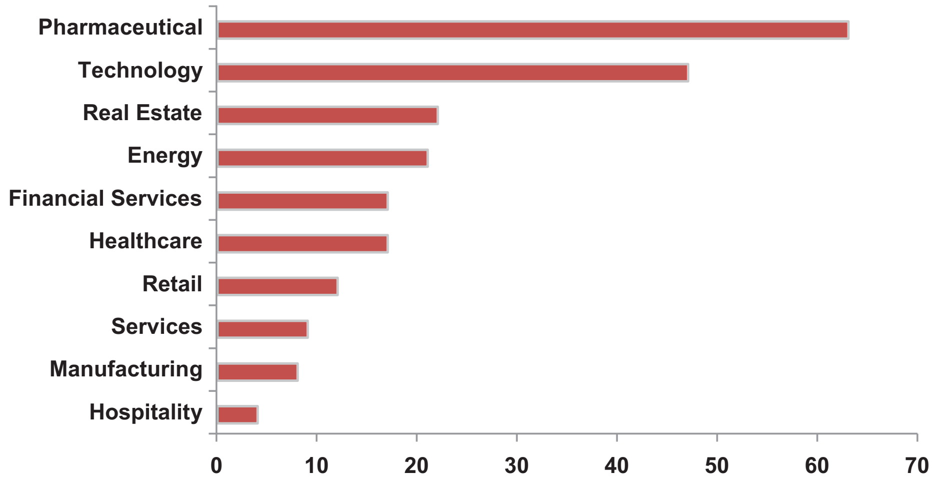
Combining Testing the Waters and Confidential Submission

In industries where valuation is uncertain and the timing of the IPO depends on regulatory or other approval (*e.g.*, biotech companies awaiting FDA approval of a new drug candidate), the ability to submit confidentially and test the waters with prospective investors can provide additional flexibility. In these industries, EGCs and their underwriters may gain useful feedback from prospective investors while maintaining confidentiality as they await both clearance from industry regulators and market conditions that are favorable to the offering.

Confidential submissions must be substantially complete when submitted to the SEC for review. However, a confidentially submitted draft registration statement need not include the consent of auditors or other experts and does not need to be signed because a confidential submission does not constitute a filing under the Securities Act.[9] An issuer does not need to name any underwriters in its first confidential submission, but the SEC Staff will typically not continue substantive review of a draft registration statement if underwriters are not named by the second submission.

Approximately 90% of EGCs that priced an IPO in year two began the IPO process with a confidential submission. This represents a significant increase (approximately 25%) in the percentage of EGCs that submitted confidentially as compared to year one.

PUBLICLY FILED EGC IPOS BY INDUSTRY



PRACTICE POINT

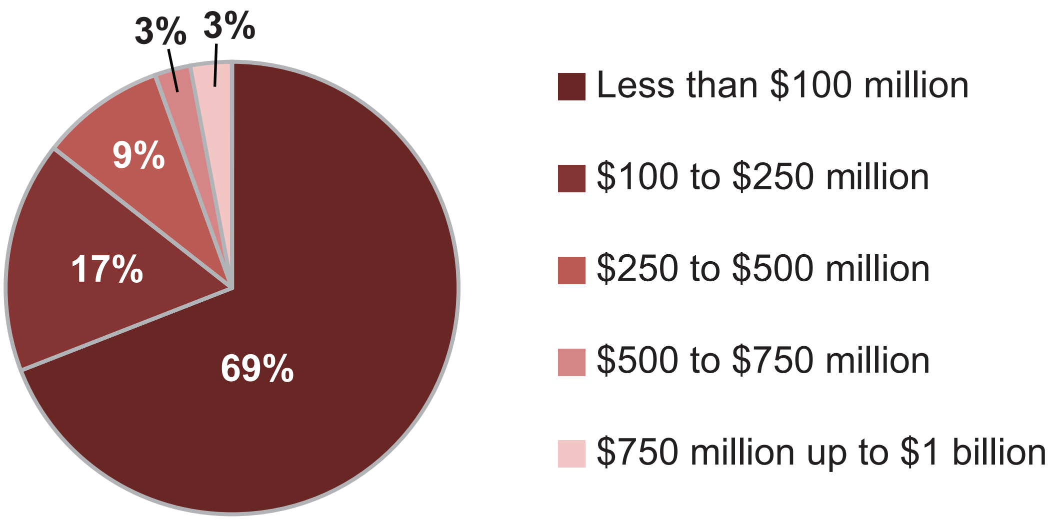
Confidential Submission vs. Filing

The distinction between "confidential submission" and "filing" is important.

- **Gun Jumping**: Rule 163A provides a safe harbor from Section 5(c) of the Securities Act for certain communications made by or on behalf of an issuer more than 30 days before a registration statement is filed. The date of the public filing, not that of a confidential submission, determines the availability of the Rule 163A safe harbor.[10]
- **SEC and FINRA Filing Fees**: Because a confidential submission is not a filing, EGCs do not need to pay SEC filing fees when they confidentially submit. SEC filing fees are paid with the first public filing. However, confidential submissions do trigger FINRA filing requirements and payment of FINRA's applicable filing fee (unless no FINRA member broker-dealer is yet involved in the offering).[11]
- **Sarbanes-Oxley**: Sarbanes-Oxley applies to an issuer that has filed a registration statement with the SEC, even if the registration statement is not yet effective. An EGC that has confidentially submitted a draft registration statement will not be subject to Sarbanes-Oxley (including Section 402's prohibition on loans to directors and officers) until the registration statement is publicly filed.

An EGC may publicly announce that it has confidentially submitted a registration statement for SEC review, and that announcement will not constitute gun jumping if Securities Act Rule 135 is followed.[12] In the past two years, approximately 10% of confidential submissions have involved this type of announcement. There may be strategic reasons for this type of announcement, in particular if an EGC is engaged in a dual-track M&A process.

EGC IPOS BY ISSUER REVENUE



PRACTICE POINT

Numbering Confidential Submissions and Public Filings

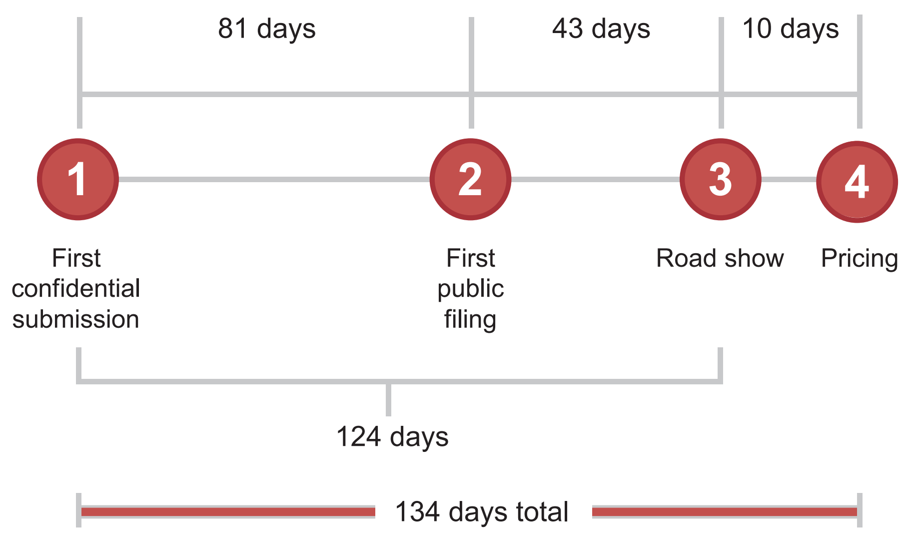
The confidential submission process has practical implications for how registration statements should be numbered and how those registration statements will appear on EDGAR.

- All confidential submissions must be made via EDGAR using the draft registration statement form type DRS or DRS/A.
- The initial confidential submission should be titled "Confidential Submission," and subsequent confidential submissions should be titled "Amendment No. 1 to Confidential Submission," "Amendment No. 2 to Confidential Submission," etc.
- Confidential submissions typically include a header such as the following: "As confidentially submitted to the Securities and Exchange Commission on [date] pursuant to the Jumpstart Our Business Startups Act."
- The first publicly filed version of the registration statement is made as an initial Form S-1 or F-1 filing and does not denote that the filing is an amendment.
- Subsequent public amendments to the registration statement then follow the traditional numbering format (*e.g.*, "Amendment No. 1 to Registration Statement on Form S-1," etc.) and use the corresponding EDGAR form type (*e.g.*, S-1/A).

The 21-Day Requirement

An EGC may not commence its IPO road show marketing process until at least 21 days after publicly filing its initial confidential submission and all confidentially submitted amendments.[13]

Approximately 90% of EGCs that priced their IPO in year two began the registration process with a confidential submission. On average, these companies made two confidential submissions before their first public filing, launched their roadshow 43 days after filing publicly (124 days after the first confidential submission) and priced 10 days after launch. This timing has been generally consistent over the last two years.



PRACTICE POINT

The Timing Tradeoff

In considering when to make its first public filing, an EGC must weigh market uncertainty against the possible harm associated with failing to complete an IPO that has been publicly announced. An EGC that switches to a public process well in advance of a planned road show can more readily take advantage of favorable market changes. However, an EGC will not want to switch prematurely to a public process and unnecessarily give up the benefits of nonpublic SEC Staff review of the draft registration statement.

Disclosure About EGC Status

The SEC Staff expects an EGC's registration statement to disclose its EGC status and address related topics, such as exemptions available to EGCs, risks related to the use of those exemptions and how and when the issuer may lose EGC status. The Staff will typically comment on each of these points and ask the issuer to state its irrevocable election with regard to the extended transition period for complying with new or revised accounting standards. If the issuer elects to use the extended transition period, the Staff will expect the issuer to explain the associated risks, such as decreased comparability with other issuers' financial statements.

Many EGCs also choose to include additional disclosure beyond what is required, even when not requested by the SEC Staff. For example, many EGCs briefly describe in the summary box or risk factors the requirements for qualifying as an EGC. Even though risk factors should not describe "risks that could apply to any issuer or any offering," EGCs often include additional EGC-related risk factors, such as a warning that the reduced requirements for EGCs could make the issuer's securities less attractive to investors or that its costs as a public company will increase further after the issuer loses EGC status. We have summarized on the following page our recommendations for typical EGC disclosure in an IPO registration statement.

Once they are public, most EGCs include some basic disclosure regarding their EGC status in their annual report on Form 10-K or 20-F. This disclosure is usually limited to risk factor disclosure similar to that which is contained in the IPO registration statement.

Scaled Financial Disclosure

At the time of its IPO, an EGC can provide two, rather than three, years of audited financial statements and as few as two, rather than five, years of selected financial data.[14] After its IPO, an EGC must phase into full compliance by adding one additional year of financial statements in each future year until it presents the traditional three years of audited financial statements plus two additional years of unaudited selected financial data.[15] An EGC's MD&A may address only the years for which it provides audited financial statements and any subsequent interim period.[16]

PRACTICE POINT

Financial Statements for Recently Acquired Businesses

An EGC that is required to include audited financial statements of a recently acquired business or significant equity investee under Regulation S-X Rule 3-05 or 3-09 may present two, rather than three, years of financial statements for these entities if the EGC is presenting only two years of its own audited financial statements in the registration statement.[17]

PRACTICE POINT

EGC-Related Disclosure for an IPO

Below is a checklist of EGC-related disclosure to include in an IPO registration statement.

- *On the* ***prospectus cover***, disclose EGC status.
- *In the* ***summary box***, disclose:
  - a brief summary of the exemptions available to an EGC, in particular the exemption from Section 404(b) of Sarbanes-Oxley and the executive compensation voting requirements of Dodd-Frank, including golden parachutes (codified in Section 14A(a) and (b) of the Exchange Act), and the ability to provide scaled executive compensation and financial statement disclosure;
  - the requirements for qualifying as an EGC and how and when the issuer may lose EGC status; and
  - if the EGC has elected to opt out of the extended transition period for complying with new or revised accounting standards, the EGC must also indicate that this election is irrevocable.
- *In the* ***risk factors*** *section*:
  - If the EGC has chosen to take advantage of the extended transition period for complying with new or revised accounting standards:
    - the EGC must include a risk factor explaining that this allows it to delay the adoption of new or revised accounting standards that have different effective dates for public and private companies until those standards apply to private companies; and
    - the risk factor must indicate that the EGC's financial statements may not be comparable to companies that comply with all public company accounting standards.
  - EGCs often also include risk factors stating that:
    - the reduced requirements applicable to EGCs could make the issuer's securities less attractive to investors;
    - the issuer's exemption from Section 404(b) of Sarbanes-Oxley's auditor attestation requirements may result in unsuccessful internal controls; and
    - the issuer may have increased costs from operating as a public company and these costs will increase once the issuer loses EGC status.
- *In the* ***management's discussion and analysis (MD&A)*** *section,* if the EGC elects to follow the extended transition period for complying with new or revised accounting standards, the EGC must include a statement in its critical accounting policies disclosure explaining that its financial statements may not be comparable to companies that comply with public company effective dates.

Nearly two-thirds of EGCs that priced an IPO in year two provided two years of audited financial statements rather than three.[18] Of those EGCs that provided three years of audited financial statements, approximately 65% partially used the accommodation for scaled financial disclosure by providing fewer than five years of selected financial data. This is a significant increase from year one, during which only one-third of EGCs used scaled financial disclosure in this manner.

In year two, 86% of EGCs provided fewer than five years of selected financial data, yet only 26% of EGCs had an operating history of fewer than five years when their IPOs priced.

PRACTICE POINT

Providing Two Years of Audited Financial Statements

The decision whether to provide two years or three years of audited financial statements should be informed by a number of factors, including industry trends, market conditions and other issuer- and offering-specific considerations. In our experience, for example, MLP issuers that are EGCs find this accommodation particularly attractive because historical predecessor financial statements for MLP issuers are often hard to produce, and creating fewer years can save significant time and cost and get the issuer to market more quickly.

This accommodation may also benefit issuers that have recently changed audit firms, allowing the new auditors to avoid re-auditing the third year of historical financial statements, resulting in cost savings for the issuer and a faster time to market. In this situation, we have also seen issuers present a third year of unaudited financial statements.

Executive Compensation Disclosure

EGCs may use streamlined executive compensation disclosure.[19] Eighty-five percent of EGCs that priced an IPO in year two took advantage of this accommodation, generally by dispensing with compensation discussion and analysis (excluding FPIs, which are not required to provide detailed CD&A).

Internal Controls Audit

As in year one, nearly all EGCs that priced an IPO in year two indicated an intention to use the JOBS Act's extended phase-in for compliance with Section 404(b) of Sarbanes-Oxley or reserved the right to do so in the future. Consistent with year one, approximately 25% of EGCs that priced an IPO in year two disclosed a significant deficiency or material weakness in internal control over financial reporting. None of these issuers indicated an intention to comply with Section 404(b) of Sarbanes-Oxley sooner than required.

In March 2014, 57 EGCs that went public in 2012 filed their second annual report on Form 10-K or 20-F.[20] None of these registrants chose to comply voluntarily with the internal controls audit provision of Section 404(b) of Sarbanes-Oxley. However, approximately 30% of these companies complied with the internal controls audit provision of Section 404(b) because they ceased to qualify as EGCs, in most cases because they became large accelerated filers.

Extended Phase-In for New GAAP

Seventy-seven percent of EGCs that priced an IPO in year two (excluding FPIs that use IFRS) irrevocably opted out of the accommodation for the extended phase-in for new accounting standards and elected from day one to follow the public company phase-in periods for new or revised accounting standards. This is consistent with the trend in year one.

PRACTICE POINT

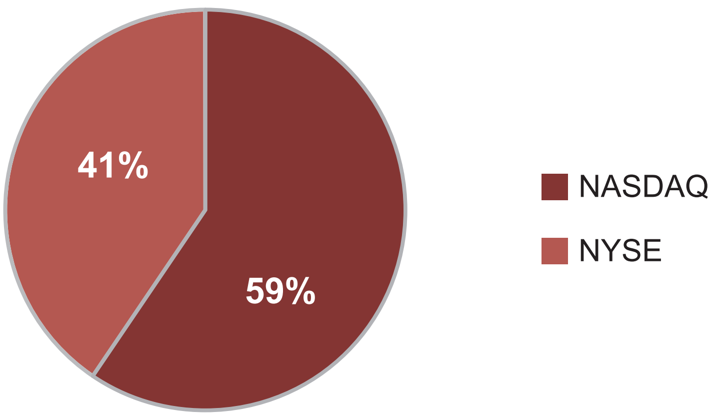
Opting Out of the Extended Phase-In

An EGC wishing to opt out of the extended phase-in for new or revised accounting standards must disclose this election in the first registration statement that is submitted to the SEC, regardless of whether it is a confidential submission or public filing.[21]

If an EGC decides not to opt out of the extended phase-in, the SEC Staff will require (i) a risk factor that indicates that the EGC's financial statements may not be comparable to those of other companies that follow public company accounting standards and (ii) a similar statement in the critical accounting policies disclosure in the MD&A.

- **Sample Opt-Out Disclosure**: "Section 107 of the JOBS Act provides that an emerging growth company can use the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. This permits an emerging growth company to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this extended transition period and, as a result, we will adopt new or revised accounting standards on the relevant dates on which adoption of such standards is required for other companies."
- **Sample Disclosure for Extended Phase-In**: "We have elected to use the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards that have different effective dates for public and private companies until the earlier of the date we (i) are no longer an emerging growth company or (ii) affirmatively and irrevocably opt out of the extended transition period provided in Section 7(a)(2)(B)."

EGC LISTINGS



Underwriting Agreements

The JOBS Act brought changes to the typical representations, warranties and covenants found in underwriting agreements.

EGCs may be asked to provide standard representations and covenants to their underwriters related to:

- EGC status;
- whether to engage in testing the waters and, if so, who may engage in those activities; and
- the contents of testing-the-waters materials.

JOBS Act-related provisions in underwriting agreements have generally remained unchanged over the past year, with a few exceptions. Almost all EGC underwriting agreements filed in year two included a representation by the issuer that it is an EGC. Fewer underwriting agreements included a representation by the issuer that it had not engaged in any testing-the-waters activities or distributed any written testing-the-waters materials as compared to year one. A majority of EGC underwriting agreements included a representation by the issuer confirming that the underwriters were authorized to conduct testing-the-waters activities on the issuer's behalf and confirming that no one other than the lead underwriters was authorized to engage in such activities.

Nearly half of EGC underwriting agreements contained a representation that there were no material misstatements or omissions in any testing-the-waters materials. In a majority of EGC underwriting agreements, the indemnity and contribution provisions covered any written testing-the-waters communications. Only a few EGC underwriting agreements included a representation by the issuer stating that it would timely file the registration statement 21 days before any road show or one affirming that no one would engage in any testing-the-waters activities. Similar to year one, we found a handful of instances in which EGCs agreed to reimburse their underwriters for expenses related to testing-the-waters activities.

Nearly all EGC underwriting agreements filed in year two included a covenant requiring the EGC to notify the underwriters of any change in its EGC status, while a majority also included a covenant requiring the EGC to inform the underwriters of any change that would cause previously distributed testing-the-waters materials to contain a material misstatement or omission.

RESEARCH ISSUES

The JOBS Act modified the rules of the road relating to analyst research reports and analyst interactions with non-research personnel in a number of significant ways.

First, Section 105(a) of the JOBS Act amended Securities Act Section 2(a)(3) to provide an exception from the definition of offer for purposes of Sections 2(a)(10) and 5(c) of the Securities Act for research reports issued by a broker-dealer regarding an EGC that is the subject of a proposed public equity offering. For purposes of this exception, a "research report" is defined expansively to include any "written, electronic, or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision." Accordingly, on its face, the definition of research report for purposes of this provision would encompass nearly any written or oral communication relating to an EGC issuer or its securities made by a broker-dealer. The SEC Staff, however, has indicated that it will view this definition somewhat more narrowly and in a manner consistent with how it views research reports that are issued pursuant to Rule 139 under the Securities Act.[22] Importantly, this means that the Staff believes the Section 2(a)(3) exception is generally available only for research reports issued by persons within a broker-dealer who function as research analysts and not by other broker-dealer personnel (*e.g.*, sales and trading personnel).

Second, the JOBS Act prohibited the SEC and FINRA from adopting or maintaining any rule or regulation in connection with an IPO of an EGC that:

- restricts based on "functional role" which employees of a broker-dealer may arrange for communications between research analysts and prospective investors;
- prohibits research analysts from participating in communications with company management in the presence of non-research personnel (*e.g.*, investment banking and sales force personnel); or
- prohibits the publication or distribution of a research report or making of a public appearance within any prescribed period of time either (a) following the pricing date of the EGC's IPO, or (b) prior to the expiration date of a company or shareholder lock-up agreement.

As a result, the JOBS Act effectively superseded for EGC IPOs existing FINRA rules that imposed research quiet periods during the 40 days (or, for participating firms other than managers and co-managers, the 25 days) immediately following an IPO, as well as during the 15 days preceding the expiration of a company or shareholder lock-up agreement with the underwriters.[23] The JOBS Act also effectively eliminated for EGC IPOs a FINRA interpretation[24] that prevented research analysts from participating in communications with internal sales personnel in the presence of company management, as well as other FINRA guidance that was generally viewed as restricting the ability of research analysts to participate in communications (other than for offering-related due diligence purposes) with company management in the presence of investment banking personnel.

The JOBS Act, however, did not provide a safe harbor for research reports from liability under Exchange Act Rule 10b-5 or other federal and state antifraud provisions of the US securities laws. Moreover, the JOBS Act did not provide a safe harbor under Section 12(a)(2) of the Securities Act with respect to oral research reports. Consequently, an oral research report could still result in Section 12(a)(2) liability if it is deemed to constitute an offer of a security and meets the criteria for liability under that provision.

SEC and FINRA Response

On August 22, 2012, the staff of the SEC's Division of Trading and Markets issued a series of FAQs regarding the research-related provisions of the JOBS Act (the Research FAQs).[25] In response to the Research FAQs, FINRA submitted a rule change proposal that was approved by the SEC on October 11, 2012.[26] In addition to the changes mandated by the JOBS Act, FINRA also implemented a suggestion from the Research FAQs to eliminate the research quiet periods following an EGC secondary or follow-on offering and during the 15 days after (not only before) the expiration, termination or waiver of an EGC lock-up agreement.[27]

Importantly, the Research FAQs confirm that the provisions of the JOBS Act that permit certain communications between research analysts and investment bankers and other non-research personnel and that allow research analysts to be present during communications between EGC management and investment banking personnel relating to a proposed IPO (including during pre-mandate pitch meetings) do not change the restrictions applicable to firms that are party to the Global Research Analyst Settlement.[28] The Research FAQs also caution that while research analysts from non-settling firms can be present during EGC IPO pitch meetings pursuant to the provisions of the JOBS Act, those analysts are still prohibited under FINRA rules from engaging in efforts to solicit investment banking business. Because of this caution and the difficulties of drawing lines between permissible and prohibited conduct, many firms are continuing to employ pre-JOBS Act policies and procedures that prevent research analysts from attending investment banking pitch meetings.

Although investment banking personnel of non-settling firms may now assist in the arranging of communications between research analysts and current or prospective investors in connection with a proposed EGC IPO, FINRA rules continue to prohibit investment banking personnel from directing research analysts to engage in such communications or in sales and marketing efforts regarding an investment banking transaction. Research analysts also continue to be prohibited from participating in road shows or engaging in communications with current or prospective investors regarding an investment banking transaction in the presence of investment banking personnel or company management.[29]

Pre-Deal Research

PRACTICE POINT

Responding to SEC Comments Seeking Pre-Deal Research Materials

If there has been no pre-deal research coverage of an EGC, you may wish to use some variation of the following responses to SEC comments seeking pre-deal research materials:

- As of the date of this letter, the Company is not aware of any research reports about the Company that have been published or distributed in reliance upon Section 2(a)(3) of the Securities Act (as modified by Section 105(a) of the JOBS Act) by any broker or dealer that is currently participating or is expected to participate in the offering.
- As of the date of this letter, the underwriters participating in the Company's initial public offering have confirmed to the Company that they have not published or distributed any research reports about the Company in reliance upon Section 2(a)(3) of the Securities Act as modified by Section 105(a) of the JOBS Act.

In addition to requesting copies of testing-the-waters materials, the SEC Staff often issues a comment relating to pre-deal research:

> *Please supplementally provide us with any research reports about you that are published or distributed in reliance upon Section 2(a)(3) of the Securities Act as modified by Section 105(a) of the JOBS Act by any broker or dealer that is participating or will participate in your offering.*

To date, we are not aware of any pre-deal research reports published by participating broker-dealers in reliance on the new exception for EGC research reports added by Section 105(a) of the JOBS Act. This appears to be the result of both regulatory and practical limitations relating to the preparation and issuance of pre-deal research reports including:

- the continuing Global Research Analyst Settlement limitations applicable to settling firms (and other firms that have otherwise agreed to comply with the settlement's substantive provisions) on communications between investment banking personnel and research analysts;
- FINRA rules that prohibit investment banking personnel from directing research analysts to engage in investor communications or sales and marketing activities relating to an investment banking transaction;
- the time necessary to produce a well-reasoned report that reflects the analyst's own personal views and satisfies FINRA and other content requirements (including that it be fair and balanced, provide a sound basis for evaluating the facts relative to the security covered, and not omit any material fact or qualification necessary in order to make the statements made in the report not misleading);

- FINRA restrictions with respect to previewing a research report with the subject company; and
- general liability, selective disclosure and issuer entanglement concerns, particularly if the analyst has been engaged in vetting discussions or has been provided with company models or estimates that are not yet reflected in a publicly filed registration statement or are otherwise known to the general public.

Note, too, that the publication by participating broker-dealers of a research report regarding an EGC may be prohibited during the restricted period applicable to securities distributions under Rule 101 of the SEC's Regulation M. For IPOs, the Rule 101 restricted period will generally commence five business days prior to the pricing date and end upon the completion of the distribution (as determined in accordance with Regulation M). Thus far, the SEC has not indicated how or if it will modify Regulation M in response to the JOBS Act.

We are aware of a small number of pre-deal research reports by non-participating firms.[30]

Post-Offering Research

Although the JOBS Act and subsequent FINRA rulemaking have eliminated post-IPO research quiet periods for EGCs under Rule 2711(f), and thus would allow participating broker-dealers to publish research reports on an EGC immediately after the IPO pricing date, it has become common for the lead underwriters in EGC IPOs to impose by contract a research quiet period on members of the underwriting syndicate. This voluntary research quiet period typically lasts (in the case of EGC IPOs that will be listed on an SEC-registered national securities exchange) until the 25th calendar day following the IPO effective date. This approach reflects the view of many industry participants that investors should be looking to the information provided in the prospectus during the prospectus delivery (or availability) period set forth in Securities Act Rule 174(d) and allows the covering analysts time to prepare their research reports and provide analysis that takes into account the information included in the final prospectus as well as post-offering developments.

PRACTICE POINT

Scope of Syndicate Research Restrictions

In cases where the EGC issuer is a subsidiary or spin-off of a parent company for which the Rule 139 safe harbor is available, consideration should be given as to whether the applicable syndicate research restrictions would allow a participating underwriter to continue to publish on the parent company. For example, a research report on the parent company may be viewed as a backdoor report on the subsidiary EGC if segment or other identifying information is provided with respect to the EGC. In addition, if the analyst covering the parent is involved in vetting the EGC offering and is in possession of material nonpublic information regarding the EGC or the transaction that would need to be disclosed in the parent company report in order to comply with FINRA content requirements or Exchange Act Rule 10b-5 or other disclosure principles, it may not be possible for the analyst to continue to publish on the parent company. Outside counsel and/or internal legal and compliance personnel should be consulted in such situations.

As noted above, FINRA rulemaking adopted in response to the JOBS Act has also eliminated for EGCs the 10-day research quiet periods applicable to secondary offerings and the research quiet periods applicable during the 15 days both before and after the expiration, termination or waiver of a lock-up agreement entered into between the underwriters and the company or its shareholders.[31] Participating underwriters appear to be taking advantage of this liberalization of the rules and are publishing research reports during these previously blacked-out periods in the ordinary course.

PRACTICE POINT

EGC Lock-Up Agreements

In our experience, lock-up agreements are generally signed in connection with the first public filing. Lock-up agreements for EGCs no longer need to include provisions designed to extend the end date of the lock-up agreement in the event that the company issued an earnings release or another significant event involving the company occurred during a specified period prior to the scheduled lock-up expiration date.[32] These provisions are no longer necessary in light of the adoption of Rule 2711(f)(5).[33]

CONCLUSION

Over the past two years, the standard IPO playbook has changed to include confidential submission, scaled financial disclosure, extended relief from Section 404(b) of Sarbanes-Oxley and streamlined executive compensation disclosure. Market practices surrounding testing the waters have also emerged, and most deal teams at least consider whether to test the waters. Research practices generally remain consistent with the status quo that existed prior to the JOBS Act's passage. The extended phase-in for new accounting standards has not gained much favor with EGCs. In sum, the trends we identified in our report one year ago have continued or increased as EGCs and other market participants have adopted a new IPO playbook.

ENDNOTES

1 Since March 31, 2013, approximately 550 issuers identifying themselves as EGCs have publicly filed a registration statement with the SEC. Out of this group, we reviewed the SEC filings of 236 issuers that successfully completed an IPO listed on a major US securities exchange. We excluded from our data set certain REIT offerings made on a best efforts basis and all offerings by closed-end investment companies made on Form N-2.

Unless otherwise noted, the data in this report are as of March 31, 2014 and are derived from the SEC filings of 236 EGC issuers as described above. We refer to this information as the year two data. When we refer to year one, we are referencing the data contained in our report of April 5, 2013, entitled "The JOBS Act After One Year: A Review of the New IPO Playbook."

Since March 31, 2013, 280 issuers (both EGCs and non-EGCs) successfully completed an IPO listed on a major US securities exchange.

2 The percentages listed in the year two column refer to the percentage of EGC IPOs that priced during the period, excluding certain offerings as described in note 1 above. The percentages listed in the year one column refer to the percentage of 184 EGC issuers that publicly filed a registration statement during the period. We selected these 184 issuers for review in connection with our report of April 5, 2013 based on (i) their successful completion of an IPO listed on a major US securities exchange or (ii) our belief that they were likely to complete such an IPO, excluding certain offerings as described in note 1 above.

3 *See* JOBS Act Sections 101(a) and (b) (adding new Section 2(a)(19) of the Securities Act of 1933 and Section 3(a)(80) of the Securities Exchange Act of 1934). After the initial determination of EGC status, a company will remain an EGC until the earliest of:

- the last day of any fiscal year in which the company earns $1.0 billion or more in revenue;
- the date when the company qualifies as a "large accelerated filer," with at least $700 million in public equity float;
- the last day of the fiscal year ending after the fifth anniversary of the IPO pricing date; or
- the date of issuance, in any three-year period, of more than $1.0 billion in non-convertible debt securities.

EGC status will ordinarily terminate on the last day of a fiscal year. However, the issuance in any three-year period of more than $1.0 billion in non-convertible debt securities would cause an issuer to lose its EGC status immediately. For purposes of this calculation, all debt securities (whether outstanding or not) count towards the $1.0 billion limit. Debt securities issued in an A/B exchange offer do not count towards the $1.0 billion limit, since they are, in effect, "the completion of the capital-raising transaction." *See* SEC Division of Corporation Finance, "JOBS Act FAQs: Generally Applicable Questions on Title I of the JOBS Act" (Sept. 28, 2012), available at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (SEC Title I FAQs), Question 18. EGC status is generally unavailable to any public company that priced its IPO on or before December 8, 2011. *See* SEC Title I FAQs, Question 2.

4 This number includes those EGC IPOs that we believe are likely to successfully complete an IPO listed on a major US securities exchange, excluding certain offerings as described in note 1 above.

5 *See* JOBS Act Section 105(c) (adding new Securities Act Section 5(d)).

6 The application of Exchange Act Rule 15c2-8(e) to testing-the-waters activities was clarified in Question 1 of JOBS Act-related frequently asked questions published by the SEC Division of Trading and Markets. *See* SEC Division of Trading and Markets, "Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters" (Aug. 22, 2012), available at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm (the Research FAQs), Question 1. As

discussed in the answer to Question 1, it should be possible for testing-the-waters activities to take place in a manner consistent with the requirements of Rule 15c2-8(e) (which generally has been interpreted to require the availability of a red herring prospectus prior to soliciting orders for the registered securities). In particular, the answer to Question 1 states that an underwriter should generally be able to seek non-binding indications of interest from prospective investors (including as to the number of shares they may seek to purchase at various price ranges) so long as the underwriters are not soliciting actual orders and the investors are not otherwise asked to commit to purchase any particular securities.

[7] Based on our review of publicly available SEC Staff comment letters from year two, the Staff issued this comment to 142 EGCs, of which 29 responded in the affirmative.

[8] *See* JOBS Act Section 106(a) (adding new Securities Act Section 6(e)(1)).

[9] *See* SEC Division of Corporation Finance, "JOBS Act FAQs: Confidential Submission Process for Emerging Growth Companies (Apr. 10, 2012), available at http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm, Question 7. In addition, a confidential submission does not constitute a filing for purposes of Sarbanes-Oxley.

[10] *See* Latham & Watkins Client Alert "The JOBS Act After Two Weeks: The 50 Most Frequently Asked Questions," available at http://www.lw.com/thoughtLeadership/jobs-act-faqs, Question 35; *cf.* SEC Title I FAQs, Question 3 ("The date of the initial confidential draft submission is not the 'initial filing date'. . . since it is not the filing of a registration statement.").

[11] *See* FINRA Rule 5110(b)(4).

[12] *See* Securities Act Rule 135 (providing a safe harbor for a limited public announcement of a proposed registered offering). The SEC Staff has informally confirmed that Rule 135 is available for an EGC wishing to announce its confidential submission of a draft registration statement in connection with a proposed IPO.

[13] *See* JOBS Act Section 106(a).

[14] *See* JOBS Act Section 102(b)(1) (adding new Securities Act Section 7(a)(2)).

[15] *See* JOBS Act Section 102(b)(2) (modifying Exchange Act Section 13(a)).

[16] *See* JOBS Act Section 102(c) (modifying Regulation S-K, Item 303(a)).

[17] SEC Title I FAQs, Question 16.

[18] Excluding EGCs with fewer than three years of operating history, approximately 55% of these EGCs provided two years of audited financial statements.

[19] *See* JOBS Act Section 102(c) (modifying Regulation S-K, Item 402).

[20] Prior to the enactment of the JOBS Act, all newly public companies had until their second annual report to comply with Section 404(b) of Sarbanes-Oxley.

[21] *See* SEC Title I FAQs, Question 13. For an EGC that does not opt out of the extended phase-in, the SEC Staff has confirmed that the EGC may later choose to comply with new or revised accounting standards on the effective dates that apply to non-EGCs, provided that the EGC must then affirmatively and irrevocably opt out of the extended transition period. *See* SEC Title I FAQs, Question 37.

[22] Securities Act Rule 139 provides a safe harbor for the issuance of research reports by broker-dealers participating in an offering of securities by certain seasoned issuers that is similar to amended Section 2(a)(3). Unlike Section 2(a)(3), however, Rule 139 is not available for the initiation of research regarding an issuer or its securities and covers only written (not oral) communications. Note also that this definition of research report is different from the manner in which a research report is defined for purposes of SEC Regulation AC as well as for purposes of FINRA's NASD Rule 2711 (Rule 2711).

[23] *See* Rule 2711(f)(1)(A), (f)(2) and (f)(4).

[24] *See* FINRA Notice 05-34 (May 2005).

[25] *See* note 6 above.

[26] *See* SEC Release No. 34-68037 (Oct. 11, 2012).

[27] The changes expressly mandated by the JOBS Act were effective retroactively to April 5, 2012. The other changes adopted to further the policies of the JOBS Act, but not expressly mandated by the provisions of the JOBS Act, were effective as of October 11, 2012. *See* FINRA Notice 12-49 (Nov. 2012).

[28] The Global Research Analyst Settlement (the Settlement) was entered into in 2003 between a number of major investment banks and the SEC and other regulators. Although the terms of the Settlement were amended in 2004 and 2010 to modify and remove certain requirements (largely due to the adoption by FINRA of similar requirements applicable on an industry-wide basis), the remaining provisions of the Settlement are still in effect. The terms of the Settlement may be modified only by court order or by an SEC or FINRA rule or interpretation that is expressly stated to supersede a particular provision of the Settlement. The SEC and FINRA have indicated that they are not inclined to modify the terms of the Settlement in response to the JOBS Act.

[29] In addition, analyst communications continue to be subject to certification and other requirements under SEC Regulation AC and to the content, approval, supervision, compensation and other requirements of Rule 2711 and FINRA Rule 2210 (regarding member communications with the public).

[30] Nearly all of these research reports were simply initiating coverage of the issuer and did not include a price target or a rating.

[31] *See* Rule 2711(f)(1)(B), (f)(4) and new (f)(5).

[32] These extension provisions were included to allow research analysts to continue to publish research around the time of the earnings release or other significant event without running afoul of the research quiet periods set forth in Rule 2711(f)(4).

[33] Although a waiver of an EGC lock-up will no longer trigger the imposition of research quiet periods under Rule 2711, the waiver itself may still require the issuance of a press release pursuant to FINRA Rule 5131, depending on the nature of the waiver and the persons for whom the restrictions are being waived.

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